UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF ILLINOIS

IN RE:	)	
	)	
JERRY L. MERRITT,	)	**No. 02-84505**
	)	
Debtor.	)	
	)	
	)	
AMERICAN GENERAL FINANCE,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	**Adv. No. 02-8248**
	)	
JERRY L. MERRITT,	)	
	)	
Defendant.	)	

O P I N I O N

This matter is before the Court following trial on the Complaint filed by American General Finance ("AGF") against the Debtor, Jerry L. Merritt ("DEBTOR"). AGF alleges that it was defrauded by the DEBTOR and that the DEBTOR used a false financial statement to obtain a loan by representing that he owned a truck free and clear of liens when, in fact, it was encumbered with an unpaid purchase money security interest. The DEBTOR maintains that AGF knew of the unpaid lien when it made the loan and did not rely on the financial statement. The Court finds for the DEBTOR and determines the debt to be dischargeable.

FINDINGS OF FACT

The sole witness for AGF was Todd Engle ("ENGLE"). ENGLE was employed by AGF for fifteen years, the last twelve years as manager of AGF'S Pekin office. Three months

prior to trial, he left AGF to work for National City Bank. As manager of the AGF Pekin office, he had direct contact with borrowers and regularly made and approved loans, both secured and unsecured.

The DEBTOR was a regular customer of AGF over a number of years and he and ENGLE knew each other quite well as a result. In December 1999, the DEBTOR purchased a used 1999 Ford F-150 from the Sam Leman dealership in Morton, Illinois. He obtained a purchase money loan from Union Planters Bank ("UNION PLANTERS") and granted UNION PLANTERS a security interest in the F-150. The loan was payable over sixty months. A few months after the purchase, the DEBTOR received in the mail, the original certificate of title to the F-150 with no lienholder shown thereon. Both parties concur that the title, free and clear of liens, was issued in error.

The DEBTOR made the monthly payments to UNION PLANTERS until August, 2001, when he was laid off from his job. In December, 2001, he obtained a loan from AGF and pledged the F-150 as collateral. The dispute revolves around ENGLE'S testimony that he had no knowledge of UNION PLANTERS' prior lien at the time he made the loan, while the DEBTOR claims he previously told ENGLE of the UNION PLANTERS' loan and title mistake. Specifically, the DEBTOR testified that after he received the title to the F-150 in early 2000, he actually showed it to ENGLE who verified that it was "free and clear." After explaining how he had gotten the title and asking ENGLE what he should do, ENGLE replied "they'll be contacting you."

The DEBTOR testified that he contacted ENGLE after he was laid off in August, 2001, about a new loan. The DEBTOR desired to pay off loans to Heights Finance and WFC, and

to refinance another loan with AGF secured by the DEBTOR'S 1986 Pontiac Firebird. Because the amount of the new loan would be about $10,000.00, ENGLE advised the DEBTOR that he would need additional collateral. At this point, the subject of the F-150 came up as possible collateral. Thereafter, according to the DEBTOR, ENGLE called the DEBTOR and said "you must be a lucky son of a gun." ENGLE stated that the DEBTOR'S credit report showed that UNION PLANTERS wrote off the loan and had no further interest in the F-150. ENGLE concluded that, under the circumstances, AGF could make the loan with the F-150 as additional collateral. On December 11, 2001, the DEBTOR and ENGLE signed the AGF Loan Agreement evidencing a loan of $9,974.28 secured by the 1986 Pontiac Firebird and the 1999 Ford F-150.

ENGLE'S version of the events that led up to the loan differ substantially. He denied that the DEBTOR ever told him about the UNION PLANTERS' loan until after he made the December, 2001 loan. He stated that the DEBTOR signed a credit application that did not list any indebtedness owed to UNION PLANTERS and that he relied on that and the free and clear title to the F-150. ENGLE acknowledged that, prior to making the loan, he obtained the DEBTOR'S credit bureau report and that the report showed a charged off account with UNION PLANTERS reported as of September, 2001, with a high credit amount of $19,217.00, but with a $0.00 balance. ENGLE stated that he interpreted that to mean that the DEBTOR did not "owe anything" to UNION PLANTERS.

After the loan was made, AGF attempted to obtain a new certificate of title to the F-150, with its lien noted thereon. The Illinois Secretary of State would not issue the new

certificate, advising AGF that its records showed that a prior, unreleased lien was held on the vehicle by UNION PLANTERS. In their joint pretrial statement, the parties stipulated that a replacement title with its lien noted thereon was issued to UNION PLANTERS on October 29, 2001. No evidence was introduced that either party was aware of this until after the December, 2001 loan was made by AGF. The DEBTOR filed his Chapter 7 bankruptcy petition on October 4, 2002, seeking to discharge his debt to AGF.

ANALYSIS

The amended complaint includes a count for actual fraud under Section 523(a)(2)(A) and a count for use of a false financial statement under Section 523(a)(2)(B). The statute provides for the nondischargeability of a debt–

> (2) for money, property, services, or an extension, renewal, or refinancing of credit–
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
> >
> > (B) use of a statement in writing–
> >
> > > (i) that is materially false;
> > >
> > > (ii) respecting the debtor's or an insider's financial condition;
> > >
> > > (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
> > >
> > > (iv) that the debtor caused to be made or published with intent to deceive . . . .

11 U.S.C. § 523(a)(2).

In order to prevail on a claim for fraud, a creditor must prove that: (1) the debtor made a representation to the creditor; (2) at the time of the representation, the debtor knew it to be false; (3) the debtor made the representation with the intent and purpose of deceiving the creditor; (4) the creditor relied on the representation resulting in a loss to the creditor; and (5) the creditor's reliance was justifiable. *Field v. Mans,* 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995).

The statutory exception to discharge for debts for money obtained by a materially false financial statement is meant to apply to those debtors who act with dishonest intent, not to those who are merely careless or negligent. *In re Jones,* 197 B.R. 949, 963 (Bankr.M.D.Ga. 1996). In order for a loan obtained by a false financial statement to be nondischargeable under Section 523(a)(2)(B), the creditor must establish each of the following five elements: (1) the debtor made a statement in writing; (2) the statement was materially false; (3) the statement concerned the debtor's financial condition; (4) the debtor intended to deceive the creditor; and (5) the creditor reasonably relied upon the misrepresentation. *In re Sheridan,* 57 F.3d 627, 633 (7th Cir. 1995). A financial statement is materially false if it "paints a substantially untruthful picture . . . by misrepresenting information of the type which would normally affect the decision to grant credit" or if the lender would not have made the loan "but for" the debtor's misrepresentations.[1] The reasonableness of a creditor's reliance should be determined on a case by case basis. *In re*

[1] Both the "substantial untruth" and the "but for" tests have been applied by courts in the Seventh Circuit, but given the result reached here, this Court need not decide which one to apply. *See, In re Morris*, 230 B.R. 352 (Bankr.N.D.Ill. 1999), *aff'd,* 223 F.3d 548 (7th Cir. 2000).

Bonnett, 895 F.2d 1155 (7th Cir. 1989). In evaluating whether a creditor's reliance was reasonable, it is appropriate to consider the following three factors:

> 1. The creditor's standard practices in evaluating credit-worthiness (absent other factors, there is reasonable reliance where the creditor follows its normal business practices);
>
> 2. The standards or customs of the creditor's industry in evaluating credit-worthiness (what is considered a commercially reasonable investigation of the information supplied by debtor); and
>
> 3. The surrounding circumstances existing at the time of the debtor's application for credit (whether there existed a "red flag" that would have alerted an ordinarily prudent lender to the possibility that the information is inaccurate, whether there existed previous business dealings that gave rise to a relationship of trust, or whether even minimal investigation would have revealed the inaccuracy of the debtor's representations).

In re Cohn, 54 F.3d 1108, 1117 (3rd Cir. 1995).

The bankruptcy court in *In re Brown,* 217 B.R. 857 (Bankr.S.D.Cal. 1998), finding that a creditor's claimed reliance on an incomplete financial statement was not reasonable in the face of a contradictory credit report, summed up its analysis as follows:

> After carefully considering the facts of the instant case, the Court finds that Beneficial has not sustained its burden of proof. First, a lender with Beneficial's knowledge, experience and competence cannot rely on a statement made by a debtor when the statement is at obvious odds with that debtor's credit report. Moreover, a lender that knows of obvious omissions in a financial statement is not permitted to nonetheless proceed with its lending, only to sue the debtor at a later date claiming intentional fraud–lenders must accept some responsibility for their sometimes unprincipled practices. Finally, a lender that extends credit in a manner and under the circumstances as presented in this case, makes the decision to do so on grounds that have nothing to do with the statements or representations of the borrower. Thus, in case such as the case at bar, there is no reliance. Beneficial's Complaint, therefore, must fail.

217 B.R. at 864.

A creditor seeking to establish an exception to the discharge of a debt bears the burden of proof. *In re Scarlata*, 979 F.2d 521 (7th Cir. 1992). A creditor must meet this burden by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). In order to afford the debtor a "fresh start," exceptions to discharge are construed strictly against the creditor and liberally in favor of the debtor. *Meyer v. Rigdon,* 36 F.3d 1375 (7th Cir. 1994).

This case turns on the Court's evaluation of the credibility of the two witnesses, the DEBTOR and ENGLE. As hereinafter explained, the Court finds the DEBTOR to be the more credible witness. After carefully listening to the DEBTOR'S testimony and observing his demeanor, the Court concludes that the DEBTOR testified truthfully. The DEBTOR is financially unsophisticated, while ENGLE, a financial services professional, is highly sophisticated. The Court finds credible the DEBTOR'S testimony that when he received the free and clear title to the F-150, he turned to ENGLE, whom he knew and trusted, to seek advice as to what he should do. The Court also believes the DEBTOR'S testimony that ENGLE told him he was a "lucky son of a gun" when he, ENGLE, discovered that the debt to UNION PLANTERS had been charged off.

ENGLE'S own testimony was equivocal. He did not make an outright denial that he referred to the DEBTOR as a "lucky son of a gun." Rather, he stated that he did not remember saying it, but that he could not definitely deny it. He offered no alternative context for such a remark if, in fact, it was said.

ENGLE admitted having the credit bureau report before the AGF loan closed. He admitted that he, not the DEBTOR, prepared the loan application that the DEBTOR

ultimately signed and that listed the DEBTOR'S debts.[2] It was ENGLE who decided not to include the UNION PLANTERS' debt on the application even though it showed up as a recent unpaid debt on the credit report. The DEBTOR stated that he went along with ENGLE because he trusted his knowledge and judgment.

Moreover, the record is devoid of any evidence that ENGLE questioned the DEBTOR about the large, charged off debt to UNION PLANTERS when the DEBTOR came to the AGF office for the loan closing on December 11, 2001, as would be expected if ENGLE really knew nothing about the UNION PLANTERS' debt. The only reasonable explanation for this remarkable lack of concern about a borrower's recent bad debt, by ENGLE, a highly experienced loan officer, is that he already knew of the circumstances surrounding the debt and, therefore, had no reason to inquire.

It is also reasonable to infer that ENGLE, the branch manager of a finance company with loan volume pressures, faced with a loan request from a valued customer that did not qualify without additional collateral, and knowing of the erroneously issued free and clear title coupled with the charge-off, might overlook the risk that UNION PLANTERS might still have an enforceable interest in the F-150, so as to be able to make the new loan to the DEBTOR. The Court finds it more likely than not that ENGLE knowingly took advantage of the situation for his own, and AGF'S, benefit, to be able to book a new loan that would not otherwise qualify without the F-150 as collateral.

For all of these reasons, the Court discredits ENGLE'S testimony that he was the unknowing victim of the DEBTOR'S scheme to defraud AGF. The Court finds that ENGLE

[2] ENGLE testified that it was common for him to prepare a loan application for a prior borrower from information in AGF'S computer files. The borrower was then expected to read it over and update or correct it before signing it.

knew of the UNION PLANTERS' debt and the F-150 title error prior to the AGF loan on December 11, 2001. The Court further finds that ENGLE did not rely upon the loan application signed by the DEBTOR. To paraphrase the court in *Brown, supra,* a lender with AGF'S knowledge, experience and competence cannot claim to rely on a financial statement when the statement is at obvious odds with the debtor's credit report and, in this case, with ENGLES'S personal knowledge of the UNION PLANTERS' loan and title error. AGF has failed to prove that its debt is nondischargeable under either Section 523(a)(2)(A) or (B) and judgment should be entered for the DEBTOR.

In his Answer, the DEBTOR asks that he be awarded his attorney fees and costs. Section 523(d) provides for such an award, under limited circumstances, as follows:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. § 523(d). Without determining whether AGF'S position was substantially justified, the Court finds that special circumstances exist that would make an award of attorney fees and costs to the DEBTOR unjust.

The DEBTOR must accept responsibility for his own actions. When he obtained the loan from AGF, he knew that UNION PLANTERS should have had its lien noted on the title to the F-150. The DEBTOR was fully aware that the "free and clear" title was issued by mistake. He could have and should have rectified that mistake by bringing it to UNION

PLANTERS' attention when he first received the title. Instead, he took advantage of the error for his own purposes. The DEBTOR should not be permitted to realize any benefit from his wrongful actions. Therefore, the DEBTOR'S request for an award of attorney fees and costs will be denied.

This Opinion constitutes this Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate Order will be entered.

Dated: February 19, 2004.

THOMAS L. PERKINS
UNITED STATES BANKRUPTCY JUDGE

Copies to:
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UNITED STATES BANKRUPTCY COURT
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vs.	)	**Adv. No. 02-8248**
	)	
JERRY L. MERRITT,	)	
	)	
Defendant.	)	

ORDER

For the reasons stated in an Opinion filed this day, IT IS HEREBY ORDERED that the debt of Jerry L. Merritt to American General Finance is determined to be dischargeable. Judgment is entered in favor of the Defendant, Jerry L. Merritt, and against the Plaintiff, American General Finance. The parties shall bear their own attorney fees and costs.

Dated: February 19, 2004.

THOMAS L. PERKINS
UNITED STATES BANKRUPTCY JUDGE

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